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No. 87-306

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

WILLIAM CONDREN and INTERNATIONAL AIR LEASES, INC.,
Petitioners,

—and—

BRANIFF, INC.,
Respondent,

—against—

AIRCRAFT TRADING AND SERVICES, INC.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT BRANIFF, INC. IN SUPPORT OF PETITION

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September 4, 1987

QUESTIONS PRESENTED

Braniff, Inc. ("Braniff") is satisfied with the questions presented by Petitioner; however, it believes they may be framed as one question as follows:

Where a secured creditor fails to perfect its security interest in an aircraft engine by recording its interest with the Federal Aviation Administration in accordance with Section 503(c) of the Federal Aviation Act (49 U.S.C. § 1403(c)) until after a buyer takes without actual or constructive knowledge of that interest, does a subsequent transferee of the collateral who has knowledge take title free of the secured creditor's security interest?

LIST OF PARTIES

The parties to the proceeding in the United States Court of Appeals for the Second Circuit were William Condren ("Condren") and International Air Leases, Inc. ("IAL"), petitioners herein, and Braniff and Aircraft Trading and Services, Inc. ("ATASCO"), respondents herein.[1]

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1 The caption of the case in this Court as set forth on the Petition apparently inadvertently omits Braniff. The parent company of Braniff is Dalfort Corporation. Braniff has no subsidiaries (except wholly owned subsidiaries) or affiliates.

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BRIEF FOR RESPONDENT BRANIFF, INC. IN SUPPORT OF PETITION

Respondent Braniff respectfully supports the Petition of Condren and IAL that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on May 22, 1987.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 819 F.2d 1227, and the slip opinion is reproduced in Appendix A to the Petition. The opinion of the United States District Court for the Southern District of New York has not been officially reported and is reproduced in Appendix B to the Petition.

STATUTORY PROVISIONS INVOLVED

In addition to those set forth in the Petition:

New York Uniform Commercial Code ("UCC" or "Code"):[2]

Section 1-103	(McKinney 1964)
Section 2-402(3)(a)	(McKinney 1964)
Section 2-403(1)	(McKinney 1964)
Section 3-201(1)	(McKinney 1964)
Section 9-301(1)(c)	(McKinney Supp. 1987)
Section 9-306(2)	(McKinney Supp. 1987)
Section 9-307(1)	(McKinney Supp. 1987)

STATEMENT OF THE CASE

Braniff supplements the statement of the case set forth in the Petition as follows.

It is undisputed that ATASCO had actual knowledge, during the period between its sale of the jet aircraft engine in question (the "Engine") to Northeastern Airlines ("Northeastern") in December 1982 and its filing of the chattel mortgage covering the Engine (the "Mortgage") in March 1985, that the Mortgage had not yet been filed and that it was required to be filed for ATASCO's lien to be perfected.

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2 The pertinent text is set forth in Appendix A hereto.

The bill of sale which Braniff filed with the Federal Aviation Agency ("FAA") after its purchase of the aircraft containing the Engine from Northeastern was consummated was an instrument by which Northeastern purported to convey to Braniff good and marketable title to the aircraft and engines (including the Engine).

It is undisputed that it is a standard practice in sales of aircraft that sellers provide purchasers with a warranty bill of sale covering the airframe and engines. Purchasers normally do not request proof of current or prior ownership of engines being sold. As Braniff was not informed that any encumbrance created by a prior owner of the Engine existed, it had no reason to request a bill of sale or other document creating the encumbrance from the prior owner. Instead it accepted and received warranties in the bill of sale furnished to it.

Similiarly, the bill of sale which Condren filed with the FAA after his purchase of the aircraft containing the Engine from Braniff was consummated was an instrument by which Braniff purported to convey to Northeastern good and marketable title to the aircraft and engines (including the Engine). Upon IAL's exercise of its irrevocable option to purchase the aircraft containing the Engine from Condren, IAL received a comparable bill of sale from Condren containing a warranty of good and marketable title.

Braniff had, and continues to have, an interest in the disposition of ATASCO's claim against IAL in view of the potential claims by IAL against Condren and Condren against Braniff predicated upon the foregoing warranties of title.[3]

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3 Braniff maintains that it has affirmative defenses to any such claims. Nevertheless, those affirmative defenses would not have to be litigated if the judgment of the Court of Appeals is reversed against IAL and the judgment of the district court is affirmed.

SUMMARY OF ARGUMENT

If the decision of the Second Circuit stands, the holder of an unrecorded mortgage in an aircraft engine would be rewarded for its delay in filing until after an innocent third party purchased the engine without actual notice of the mortgage. It could recover against a subsequent purchaser from the innocent third party or against remote purchasers years later.

Sales of aircraft and engines typically involve providing warranties of good and marketable title. If the ruling below is left unchallenged, a secured party who belatedly perfects would achieve indirectly what it could not do directly. The secured party would circumvent the protections afforded by a recording statute by reaching one of the innocent third party's transferees, which would trigger successive claims for breach of warranty of title all the way back up the chain of ownership to the innocent third party. Such a result would have a draconian effect on numerous conveyances and should not be sanctioned.

Rather, the interplay of the aircraft recording statute, 49 U.S.C. § 1403, with section 9-301(1)(c) of the Uniform Commercial Code and the "shelter" provision contained in section 2-403(1) of the Code should render the innocent third party and all subsequent transferees not liable to the dilatory secured party.

ARGUMENT

Braniff concurs in the reasons for granting the writ set forth in the Petition. Those reasons will not be reiterated except as appropriate. Braniff will advance additional reasons for granting the writ, including those involving the Uniform Commercial Code.

I. THE WRIT SHOULD BE GRANTED AS THE DECISION BELOW THREATENS THE INTEGRITY OF THE FEDERAL SYSTEM FOR CENTRALLY RECORDING INTERESTS IN AIRCRAFT AND AIRCRAFT ENGINES AS WELL AS SIMILAR RECORDING STATUTES

The importance of the issue presented cannot be overstated. In holding that a secured party, who delays recording until after an intervening innocent purchaser, nonetheless prevails as against a subsequent transferee, the Court of Appeals effectively adopted a rule by which the title of the innocent purchaser may be retroactively impaired and that party exposed to a claim for breach of warranty of title. The innocent purchaser's search of the FAA records—or any comparable central registry—prior to consummating the transaction is thus reduced to an exercise in futility.

Such a rule, if permitted to remain unchallenged, could unsettle countless commercial transactions that depend upon the sanctity of the recording statutes. It would run counter to the primary congressional purpose for the passage of section 503(c) of the Federal Aviation Act of 1958, as amended (the "Act"), 49 U.S.C. § 1403(c), recognized by this Court in *Philko Aviation, Inc.* v. *Schacket*, 462 U.S. 406, 411 (1983):

> ". . . to create 'a central clearing house for recordation of titles so that a person, wherever he may be, will know where he can find ready access to the claims against, or liens, or other legal interests in an aircraft.' "

This case considers the construction and application of the Act. The decision of the Court of Appeals is significant in the administration of the Act—it poses a serious threat to effective administration. Concomittantly, the decision of necessity is of vital concern to the aircraft industry and the lending community, if not also to potential buyers everywhere who depend upon recording statutes for protection. This Court should settle a critical question of first impression decided by the

Second Circuit. For all these reasons, the writ should be granted.

The integrity of the FAA recording system would be severely undermined if the first purchaser following the granting of the security interest could not rely upon the FAA registry as he found it. Any number of sales could occur but title would be forever impaired, if a secured party successfully (by gaining priority) filed before a later sale whether the later sale was the second or the ninety-ninth. Adherence to the reasoning of the Second Circuit would reward a secured party for ignoring the recording statute by neglecting to file promptly, which is "not what Congress intended." *Philko Aviation, Inc.* v. *Schacket*, *supra*. Rather, Congress intended that a transferee look no further than the FAA records "to acquire his interest with the certain knowledge that the transferor's title is clear." *Id.* at n.5 & 413 n.7.

If the "shelter" provision does not apply, a subsequent transferee without knowledge at the time he acquired an aircraft or an aircraft engine (such as Condren), which was prior to the secured party's filing, might be required to operate the aircraft or the engine or keep it in storage forever after, as he could not convey the aircraft or the engine free and clear of liens after the secured party finally filed its interest with the FAA for recordation. This would be an absurd result because of its unsettling implications for conveyances dependent upon recording statutes. Any subsequent conveyance(s) would set in motion claims for breach of warranty of title that would extend back to the first innocent purchaser. That innocent purchaser would be penalized rather than the dilatory secured party who should bear the loss caused by his failure to record promptly. The law cannot permit a result that rewards a wrongdoer for his own wrongdoing.

This Court should not condone a judicial concept of a "springing defect." If the Court of Appeals' rationale is correct, airlines might never be in a position to satisfy potential buyers or lenders that reasonable expectations concerning fu-

ture disposition will not be frustrated by the subsequent filing of an interest that may have been created many years earlier but is unknown to everyone because it was never before recorded. Unless overturned, the judgment against IAL may well lead to just that result.

II. THE APPROPRIATE CONSTRUCTION AND APPLICATION OF THE UNIFORM COMMERCIAL CODE REQUIRE RESORT TO THE SHELTER PRINCIPLE FOR NON-ORDINARY COURSE BUYERS WHERE A CENTRAL RECORDING SYSTEM IS INVOLVED, CONTRARY TO THE DECISION BELOW

The Second Circuit predicated its holding upon its construction and application of various sections of the Uniform Commercial Code. Priority is properly accorded to Braniff, Condren and IAL over ATASCO, however, as a matter of state or federal law once Braniff or Condren purchased the Engine without actual notice of the Mortgage which had not yet been filed with the FAA. In contrast with the Court of Appeals, the district court found that any subsequent sale passed good title to the Engine free of ATASCO's lien. This proposition necessarily follows from common law principles governing passage of title, the Uniform Commercial Code in which those principles are codified or the policy behind the federal recording statute for conveyances of aircraft.

The long-standing principles regarding the passage of title are now codified in section 2-403(1) of the Code. The Court of Appeals' refusal to allow that section or its concept of "shelter" to apply to section 9-301(1)(c) of the Code ignores sound policy reasons behind the necessary interplay of those sections. The free alienability of goods is promoted by protecting innocent buyers and their transferees from the interests of the (unperfected) creditors of their sellers. *Matter of Gary Aircraft Corporation*, 681 F.2d 365, 370 (5th Cir. 1982), *cert. denied*, 462 U.S. 1131 (1983). *Cf. Official Comment* 3 to UCC § 3-201.

The Court of Appeals found Braniff to be a non-ordinary course buyer. Section 9-301(1)(c), however, protects innocent buyers in Braniff's class, who take delivery and give value, from an unperfected security interest. Any such buyer takes good title free of a security interest if it was not perfected at the time of purchase.

The Second Circuit unduly relied on the literal language of section 9-301(1)(c) that the unperfected security interest is "subordinate" to the rights of the innocent purchaser. Section 2-403(1) applies such that subsequent transferees step into the innocent purchaser's shoes, and the unperfected security interest is "subordinate" to their rights as well. Stated differently, a successful section 9-301(1)(c) buyer *is* treated as one who "takes *free* of the [unperfected] security interest." *White Star Distributors, Inc.* v. *Kennedy*, 66 A.D.2d 1011, 411 N.Y.S.2d 751, 752 (4th Dept. 1978) (Emphasis supplied). *Accord*, *United States* v. *Handy and Harman*, 750 F.2d 777, 781, 786 (9th Cir. 1984).

In *Handy and Harman*, the Ninth Circuit stated that the defendant "must fit within one of [section 9-307(1) or section 9-301(1)(c)] in order to take the collateral free of the government's security interest." *Id.* at 781. The court went on to note that, in the case of a successful section 9-301(1)(c) buyer, "the security interest has been cut off," *id.* at 786, and that "[i]n the absence of an enforceable security interest, the usual rules of priority favoring secured parties are inapplicable." *Id.*[4]

The use of slightly different language in section 9-307(1) gave the Court of Appeals considerable though unnecessary pause. As Judge Miner's Opinion recognizes, 819 F.2d at 1233-34, it has been suggested that the draftsmen of the Code nonetheless intended that an unperfected security interest terminates upon subsequent sale of the collateral to a buyer not in

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4 *Cf. South Shore Bank* v. *Johnson Hydraulic Mfg. Co.*, 131 Ill. App. 3d 1024, 477 N.E.2d 1, 4 (Ill. App. 3d Dist. 1985). In *South Shore Bank*, it was held that as against the plaintiff, the rights of the defendant obtained by purchasing an aircraft were "invalidated" by its failure to duly record the transfer documents with the FAA prior to the plaintiff's recordation.

the ordinary course of business, but that an unperfected security interest subject to a senior lien continues. *See* D.G. Carlson, *Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors,* 5 Cardozo L. Rev. 547, 551-57 (1984).

To regard the literal language of section 9-301(1)(c) as controlling is to do violence to the time-honored doctrine that secret liens are not favored out of fairness to the innocent buyer. This doctrine "was never based on any distinction between transactions in and out of the ordinary course of business." Carlson, *supra*, at 556. A statutory definition should not be read mechanically where to do so would defeat the purpose of the legislation. *Philko*, *supra*, 462 U.S. at 412.

Section 9-301(1)(c) applies to unperfected security interests, whereas section 9-307(1) applies to perfected security interests. This distinction renders the Court of Appeals' implicit economic analysis of the supposed difference in the protections afforded by section 9-301(1)(c) and section 9-307(1) faulty. Non-ordinary course sales under section 9-301(1)(c) should be afforded the same "blanket" protection afforded ordinary course sales under section 9-307(1), rather than "transactional" protection, because the secured party has not yet perfected and therefore deserves (and should expect) less protection than if he had perfected.

The status of a non-ordinary course buyer vis-á-vis an unperfected security interest should be no different than the status of an ordinary course buyer vis-á-vis a perfected security interest. The Second Circuit therefore placed undue reliance upon section 9-307(1) being the subject of *Gary Aircraft*, *supra*. *See* 819 F.2d at 1234. Official Comment 1 to that section itself notes that "Section 9-301 should be consulted to determine what purchasers, in addition to the buyers covered in this Section, take *free* of an unperfected security interest." (Emphasis supplied).

Section 9-301(1)(c) should not be deemed to take away rights that are conferred under Article 2 of the Code. This is confirmed by section 2-403(1), which provides in pertinent part:

> "A purchaser of goods acquires all title which his transferor had or had power to transfer . . . ."

Section 2-403(1) incorporates "[t]he basic policy of our law allowing transfer of such title as the transferor has." *Official Comment* 1 to UCC § 2-403. The wisdom of the policy embodied in Article 2 of the Code for "Sales" should also be applied with respect to Article 9 for "Secured Transactions." Any other policy would result in the kind of uncertainty and unsettling of vested rights as that encouraged by Judge Miner's erroneous conclusion.

Due to ATASCO's failure to perfect its lien before Braniff purchased the Engine and Braniff's lack of knowledge of the lien, ATASCO's interest in the Engine became subordinate under section 9-301(1)(c) to the rights of Braniff. Pursuant to section 2-403(1), Braniff's subsequent transferees, including Condren and IAL, should acquire Braniff's superior status regardless of the state of their knowledge.

Though the Second Circuit rejected this statutory construction, it effectively received judicial approval in New York in *Williamson* v. *Mason*, 12 Hun. 97, 108-09 (1877):

> "A purchaser with notice will secure a good title by obtaining it from a party who had no notice, and may hold the property bought against the equities of a party otherwise entitled to be regarded as the true owner."

While *Williamson* is a pre-Code decision, its logic remains sound law. *See also General Motors Acceptance Corporation*

v. *Raz Delivery*, 238 A.D. 277, 264 N.Y.S. 412, 415 (4th Dept. 1933);[5] *Official Comment* to UCC § 3-201.[6]

The common law "shelter" principle is codified in section 1-103 ("Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions.") and section 2-403(1). Any argument that section 2-403(1) does not explicitly protect against a security interest must lose its force as section 1-103 may be utilized to reach the same result. *Cf.* J. White & R. Summers, *Uniform Commercial Code* § 3-11, at 140 (2d ed. 1980).

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5 *Raz Delivery* held that a conditional vendor could not assert a reserved title as against the vendee upon the vendee's reacquiring the property from a purchaser at a trustee's sale after the vendee's discharge in bankruptcy. The conditional vendor's reserved title was held as security only, and its claim as a result of the intervening right of the trustee in bankruptcy was reduced to an unsecured claim against the bankrupt's estate which was discharged in the bankruptcy proceedings.

6 The "shelter" principle is also set forth explicitly in section 3-201(1) with respect to commercial paper: "Transfer of an instrument vests in the transferee such rights as the transferor has therein." The pertinent portions of the Official Comment to that section are illuminating:

> "1. The section applies to any transfer, whether by a holder or not. Any person who transfers an instrument transfers whatever rights he has in it. The transferee acquires those rights even though they do not amount to 'title.'
>
> * * *
>
> "3. A holder in due course may transfer his rights as such. The 'shelter' provision of the last sentence of the original Section 58 is merely one illustration of *the rule that anyone may transfer what he has. Its policy is to assure the holder in due course a free market for the paper*, and that policy is continued in this section. . . . The operation of the provision is illustrated by the following examples:
>
> > (a) *A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes as a holder in due course. After the instrument is overdue B gives it to C, who has notice of the fraud. C succeeds to B's rights as a holder in due course, cutting off the defense.*" (Emphasis supplied).

Section 9-307 should not be construed to afford the sole exception to the general rule stated in section 9-306(2) that a security interest in collateral continues upon the sale of the collateral unless the sale was authorized by the secured party. Section 9-301(1)(c) should be deemed to afford another exception under the analysis set forth above.

Likewise, the prohibition of section 2-402(3)(a) against impairing the rights of secured creditors is not jeopardized by resort to section 2-403(1). Rights are not impaired when they are already lost. Here, ATASCO's loss occurred upon the initial transfer to Braniff pursuant to section 9-301(1)(c). Section 2-403(1), as applied to subsequent transferees, did not "impair" any rights of ATASCO. Those rights were already subordinate to Braniff, and should therefore be subordinate to its transferees, Condren and IAL.

The Second Circuit's reliance upon *National Shawmut Bank* v. *Jones*, 108 N.H. 386, 236 A.2d 434 (1967), to avoid the application of section 2-403(1) is misplaced. *National Shawmut* considered only the second sentence of section 2-403(1)—the "voidable title" provision—and held inapplicable that provision alone. The "voidable title" provision is *not* the portion of section 2-403(1) upon which reliance here is placed. Rather, reliance is placed upon the first sentence of section 2-403(1)—the "shelter" provision.[7]

In quoting *Gary Aircraft*, *supra*, 681 F.2d at 877, the Court of Appeals, 819 F.2d at 1234, omitted the rest of the critical portion of the decision. The missing portion states precisely that the *National Shawmut* rule does *not* preclude the availability of section 2-403(1) to subsequent transferees from a successful section 9-307(1) buyer. *Gary Aircraft* held that section

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7 *Official Comment* 4 to UCC § 2-403 also supports subsection (1)'s application to section 9-301(1)(c). It states:

> *"Except as provided in subsection (1)*, the rights of purchasers other than buyers in ordinary course are left to the Articles on Secured Transactions, Documents of Title, and Bulk Sales." (Emphasis supplied).

2-403(1) is available. 681 F.2d at 877. It should also be available to subsequent transferees from a successful section 9-301(1)(c) buyer.[8]

If a warranty of title is to mean what it says, and not to come back to haunt a prior innocent purchaser who furnished it in good faith, the decision of the Court of Appeals against IAL must be overturned. Otherwise, the dilatory secured party, here ATASCO, is rewarded to the detriment of the innocent purchaser.

Such a result flies in the face of well-established legal principles and is contrary to fundamental policy concerns. The "subsequent perfecting of a security interest can not operate retroactively to impair rights in the collateral acquired by innocent parties for value prior to perfection." R.A. Anderson, *Anderson on the U.C.C.* § 9-301:9, at 29-30 (3d ed. 1985). Though the Code does not attempt to remove all uncertainty from secured transactions, the FAA recording statute does. The Code must be construed in light of that Act if commercial transactions involving aircraft and aircraft engines are to have any sanctity.

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8 *See* White & Summers, *supra*, § 25-15, at 1074 n.100 (One of the authors disagrees with the other "and would read 2-403 broadly to protect the innocent purchaser."); Carlson, *supra*, at 558 (The argument that there is significance in the failure to provide shelter explicitly in section 9-301(1)(c) "could be countered by contrary evidence, such as a showing that denial of shelter to buyers under section 9-301(1)(c) violates the fundamental philosophy of the UCC priority system." . . . . "Justification . . . exists for the proposition that shelter provisions should be read generously into the UCC wherever necessary to protect the marketability of a senior party's priority.")

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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September 4, 1987

APPENDIX

APPENDIX A

New York Uniform Commercial Code:

§ 1-103. Supplementary General Principles of Law Applicable

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

§ 2-402. Rights of Seller's Creditors Against Sold Goods

* * *

(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the Article on Secured Transactions (Article 9); or

* * *

§ 2-403. Power to Transfer: Good Faith Purchase of Goods; "Entrusting"

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale", or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

* * *

§ 3-201. Transfer: Right to Indorsement

(1) Transfer of an instrument vests in the transferee such rights as the transferor has therein, except that a transferee who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

* * *

§ 9-301. Persons Who Take Priority Over Unperfected Security Interests; Right of "Lien Creditor"

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

* * *

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business, or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

* * *

§ 9-306. "Proceeds"; Secured Party's Rights on Disposition of Collateral

* * *

(2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

* * *

§ 9-307. Protection of Buyers of Goods

(1) A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

* * *